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SUBJECT: INITIAL FIRST QUARTER GDP STATS MAY BE MISLEADING

¶1. (U) SUMMARY: The Department of Census and Statistics (DCS), an agency coming within the Ministry of Finance and Planning, has released quarterly Gross Domestic Product (GDP) data for the first quarter of 2006. According to these statistics, GDP in the first quarter of 2006 was 7 percent more than the first quarter 2005 GDP. The growth reflects a recovery from the tsunami-affected first quarter of 2005 when GDP (as measured by the DCS) grew by 5 percent over the first quarter 2004 figure. This cable outlines some of the causes of the GDP growth. END SUMMARY.

¶2. (SBU) Robust growth rates in the three major sectors helped growth: agriculture grew by 11 percent, industry by 6.6 percent and services by 6.2 percent over the corresponding period in 2005. Encouraged by these figures, senior government officials have declared that the Sri Lankan economy is resilient and would be seeing similar growth rates in the next three quarters. Dr Dushny Weerakoon, Deputy Director of the Institute of Policy Studies, an economic think tank in Colombo, also confirmed that they do not dispute the overall trend of strong growth in the economy where growth has exceeded 6 percent in every quarter beginning from the second quarter of 2005. If there is no breakout of full-scale war, IPS expects to see growth over 6 percent for the year 2006. According to Weerakoon, there has been a clear turnaround in agriculture, with good weather and government policies helping rice and other crops. Other sectors, especially services, are also continuing their growth from last year. Construction in particular is robust due to tsunami reconstruction activity.

¶3. (U) However, these numbers should be viewed with care for several reasons. They reflect economic activity in January to March 2006 before violence increased in April 2006. The growth also reflects a recovery from the tsunami destruction. In particular, growth in agriculture is partially attributed to a spectacular recovery in fisheries (250 percent) from a decline of 77 percent in the corresponding period in 2005. The construction sector is also doing particularly well due to tsunami reconstruction activities. Inflation was significantly lower in the first quarter of 2006 when compared to 2005. According to present trends a much higher rate of inflation during the rest of the year is likely, which could affect growth. Currently, inflation as measured by the Colombo Consumer Price Index is running over 13 percent. Furthermore, quarterly GDP numbers reported in Sri Lanka are not/not seasonally adjusted and

annualized and therefore would not indicate annual trends.

¶4. (U) Meanwhile, the high world oil prices, subsidies, and the absence of usual budgetary and balance of payment support from the ADB, World Bank and the IMF (due to the government's inability to move ahead with reforms) could cause a strain on the finances of the country. Besides, the government has been forced to postpone its plans to raise up to USD 1 billion in a 7 to 10 year sovereign bond issue, due to lack of interest in the investment community, at least in part due to the current security situation. The financial situation could worsen further if the government seeks to increase defense expenditure. These developments could result in significant pressure on the rupee and increase inflation rates, which would slow economic growth.

¶5. (SBU) Comment: The Central Bank, Sri Lanka's traditional source of GDP data, has not yet published its statistics for the first quarter. Generally, the level of professionalism within the Central Bank, and relative insulation from national politics, lend greater authority to its reports than is enjoyed by the DCS. The Central Bank data are to be released on June 30. The Embassy will report more on this matter in early July if the Central Bank data are significantly different from that of the DCS.

Lunstead